

M e m o r a n d u m**330.3974**

To: Los Angeles District - District Principal Auditor

Date: September 12, 1968

From: Tax Counsel (TPP:LAA) - Headquarters

Subject:

This is in response to your memorandum of March 25, 1968, concerning the taxability of equipment leases under a restaurant franchise agreement.

We understand the facts to be these. A certain restaurant chain forms separate corporations for each of its locations. Each of these corporations arranges with an outside landowner to erect a restaurant building and the corporation leases the land and building. The corporation then purchases from several suppliers on a tax-paid basis all of the equipment necessary to operate a restaurant: dishes, utensils, glassware, pots and pans, tables, chairs, booths, stools, counters, refrigeration and cooking equipment, etc. I assume installation is provided by the vendor or third parties.

The location thus outfitted is either operated by the corporation until franchised or franchised immediately. The franchise agreement provides for the sublease of the land and building and a lease of the equipment to the franchise holder on a percentage basis.

In a sense, then, management effort has combined individual items into a going restaurant unit which is leased to the franchise holder. The question raised is whether this process of assembly results in a substantial change in the form of the individual items of equipment so that the lease no longer comes within the exception of Revenue and Taxation Code section 6606(g)(5) and ruling 70(c)(2)(B).

In our opinion this is no substantial change in form and the lease is not subject to tax.